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Joint Urban Service Program



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EUGENE, OREGON
October 9, 1987

Betty Hulse
City Recorder
PO Box 128
Elgin OR 97827

Dear Betty:

Under the joint Urban Service Program of the League and the Bureau, we are responding to your question on whether water and service revenues must be placed in a separate fund.

We were unable to find any statutory requirement to that effect. We have enclosed pages 22 to 28 from the Department of Revenue's Budget Manual. These pages contain a discussion of the kinds of funds commonly created by taxing entities. You'll note that on page 23 the text states that a water and sewer fund can be created by a local government, but does not imply that it must be created.

You probably will want to consult with your auditor and city attorney, but in the meantime, I hope this will be useful to you.

Sincerely yours,

Sandra L. Arp
Legal Consultant

SLA:mm
Enclosure

6 Types of funds

A taxing district's financial information serves a variety of functions and users. The primary classification of governmental expenditures is by fund. A fund is defined as "a fiscal and accounting entity with a self-balancing set of accounts, recording cash and other financial resources, which are segregated for the purpose of carrying on specific activities or obtaining certain objectives in accordance with special regulations, restrictions and limitations."

All governmental units receive financial resources that may be used only in accord with restrictions established by law or agreements with donors or grantors. It is through the use of fund accounting and budgeting that governmental units demonstrate compliance with the restrictions imposed on use of resources.

Funds should be kept to a minimum and should not be established merely to separate certain receipts or to separate the expenses associated with activities. The governing body of each local government should determine the funds necessary for its financial operation and initiate a resolution authorizing their establishment. Requirements for separate funds are found in statutes, home rule charters, resolutions or ordinances of the local government, and state and federal regulations and guidelines of good accounting practice.

Funds may also be created by the governing body of the local government to control the use of restricted or dedicated revenues. However, governmental units should maintain only those funds required to meet legal and operating requirements, since unnecessary funds can create inefficiency and undue complexity.

Many specific statutes that authorize local governments to levy taxes or to provide special services require the establishment of a separate fund. Examples of such funds are: The Bancroft Bond Fund (ORS 223.285), County School Fund (ORS 328.005), Reserve Funds (ORS 280.100), Bond Proceeds Fund (ORS 287.070), Debt Service Fund (ORS 287.006) and Serial Levy Fund (ORS 280.110).

As a general rule, special funds should be created under the following conditions:

1. A fund must be created when required by law or by a contractual agreement. Certain statutes require that a fund be created to administer certain receipts.
2. A fund should be created to receive and disburse the proceeds from a bond issue. Bonds are authorized for specific purposes. The expenditure of the money obtained from a bond issue for other than authorized purposes is illegal. To help prevent illegal expenditures from a bond issue, a separate fund is established to account for bond proceeds. A bond fund is temporary in nature. When the project for which the bonds were issued is completed, any remaining money is to be transferred to the debt service fund unless otherwise authorized by law.

3. A fund can be created for utilities (water and sewer) operated by a local government. A utility service is generally operated on a self-supporting basis. A separate fund makes it possible to establish separate accounting data on the operations of the utility. This information can be used to set up the service charges for the utility, and provide better controls and information on the management of the resources and expenditures.

In some instances, statutes authorizing special levies do not specifically require the establishment of a separate fund. However, from the general requirement that the proceeds of all special levies must be used for the specific purpose authorized, it is implied that separate funds be established for such special levies, under ORS 311.350. Article 11, Section 3, Oregon Constitution, states that "no tax shall be levied except in pursuance of law, and every law imposing a tax shall state distinctly the object of the same to which only it shall be applied." By establishing a special fund in which certain expenditures will occur, a general classification or description of the expenditure items is provided.

Cities operating under home rule charters usually provide for a general fund and several additional special funds. The number and type of such funds depend upon the activities of the local government and the organizational structure at the time the charter was adopted. When cities engage in activities authorized by state law, funds should be established as provided by these statutes.

The estimates of expenditures for the ordinary operation of a municipal corporation are shown in the General Fund. Special funds are created to help ensure that a specific purpose is being accomplished with special resources and expenditures.

Eight major types of funds are used in setting up budget and accounting records: General Funds, Special Revenue Funds, Capital Project Funds, Debt Service Funds, Special Assessment Funds, Internal Service Funds, Enterprise Funds, and Trust and Agency Funds. Any of these fund types may be used, depending upon the complexity and level of activity for each local government.

General Funds

Financial transactions relating to all governmental activities for which specific types of funds are not required are recorded in a General Fund. This fund is used for all receipts not dedicated for a specific purpose. In most cities, this includes such activities as streets, fire and police protection, and general administration.

Special Revenue Funds

Special Revenue Funds should be established only for special tax levies and other dedicated revenues whenever required by statutes, charter provisions, or the terms under which revenue is dedicated. The number of special revenue funds should be kept to a minimum.

Capital Project Funds

All resources used to finance the construction or acquisition of capital facilities, which are by definition nonrecurring and major expenditure items, are recorded in a capital project fund. Resources include not only the proceeds from the sale of general obligation bonds, but also any grants, transfers, or other revenues authorized for the financing of capital projects. A separate fund is normally established when a capital project or series of projects is authorized by the voters; it is closed when the projects are completed. Several related projects financed from one bond issue may be accounted for in one fund if there are no provisions to the contrary in the authorization to sell the bonds.

Debt Service Funds

A fund established to account for the payment of principal and interest on all general obligation long-term debt, including that payable exclusively from revenue-producing enterprises. There may be several bond issues accounted for in one debt service fund. Separate accounts would be set up for each bond issue. Transactions to record the redemption of existing bonds with proceeds of refunding bonds are also recorded in debt service funds.

Special Assessment Funds

Special assessment funds account for the construction of improvements which are paid for from special assessments against benefited property. ORS 294.326(5) exempts these revenues from Local Budget Law requirements. Only the revenues received from assessments, as defined in ORS 223.205(2), where at least 80 percent of the revenue is received from the benefited property owner, are exempt. Local improvements assessed against benefited property include streets, sidewalks, sanitary or storm sewer or water mains, off-street motor vehicle parking facilities, flood control dikes or dams, etc.

The purpose of the Bancroft Bonding Act is to provide a means so the improvements can be paid off by the property owner in equal annual installments rather than requiring complete payment in one lump sum. ORS 223.285 requires the creation of a "Bancroft Bond Redemption Fund" to record the debt payments for principal and interest where bonds were issued to cover the assessed property's costs for improvements.

The ordinances which authorize the bonds should determine whether each separate issue requires a separate fund, or each issue is accounted for separately in one fund (ORS 223.285).

Internal Service Funds

The purpose of an internal service fund is to finance and account for services furnished by a department or agency to other departments or agencies within the municipal corporation. Amounts expended by the fund are restored from either operating earnings or as operating expenditures from other funds to the internal service fund. The original working capital is then kept intact.

Enterprise Funds

A fund established to finance and account for the acquisition, operation, and maintenance of governmental facilities and services which are entirely or predominately self-supporting by user charges and fees. Examples of enterprise funds are those for water, gas and electrical utilities, swimming pools, airports, parking garages, and transit systems. Separate funds should be established for each utility or enterprise.

Trust and Agency Funds

Assets are sometimes held, or revenue received, by municipalities in a fiduciary capacity to be used for a certain specified purpose. For example, investments or securities may be given to the municipality with provisions that the income be used to aid the library or park system. In other cases, the municipality may charge a certain amount for perpetual repair of cemetery lots, with such amount to be invested and only the earnings used for the designated purpose.

Reserves and Special Funds

A taxing district may establish reserve or special funds for the accumulation of money under ORS 280.040 to 280.140 for certain purposes specified in ORS 280.050.

Originally, the statutes authorized the use of reserve and special funds for special projects such as the construction of new office buildings, a road improvement project, or the like. Now the purposes stated in the statutes are sufficiently broad to cover any facet of the financial operations of a taxing district. ORS 280.100 permits any city, town or port by ordinance, and any other subdivision by resolution, to establish a financial reserve or special fund for the purposes specified in ORS 280.050. The question need not be submitted to the voters if the taxes levied or other revenue used for the purpose of establishing the fund are within the tax base as defined by Section 11, Article XI, of the Constitution. If it would be necessary to exceed the tax base in order to obtain revenue for any new reserve or special fund, the tax levy would have to be authorized by the voters.

ORS 280.100 requires that the annual increments to such funds be limited to any period not to exceed 10 years. Any balance in a fund referred to in ORS 280.110 not extended or obligated by definite commitments within 12 years from the establishment of the fund becomes a part of the General Fund of the taxing district and must be transferred by the treasurer or other financial officers as required. (ORS 280.120.) All revenues received by any taxing district as authorized by ORS 280.040 to 280.140 must be kept by the treasurer or other financial officers in a fund or funds separate and distinct from other funds of the taxing district. Moneys may be retained or expended only for the purposes for which the special fund was created. Money cannot be accumulated in a reserve fund to reduce the operating expenditures in the budget.

Reserves and Special Funds:

1. May be established by enacting a proper ordinance or resolution.
2. Must be separate and distinct from other funds and be established for a specific purpose.
3. May be established at any time, but appropriations can be made only at budget time or with a supplemental budget.
4. The annual increments to such funds are limited to a period not to exceed 10 years.
5. Any unexpended balance not expended or obligated 12 years after the fund was established must be transferred to the General Fund after adoption of a resolution or ordinance.
6. Any unexpended balance remaining after a 12-year period reverts to the General Fund.
7. Reserve funds must become part of the budget document, be included with the "Total Budget All Funds" represented in the LB-1 form, and reflect all available resources. This includes all resources which have been previously budgeted, including all cash on hand and time certificate of deposit monies.
8. When financed by a serial levy, expenditures are limited to the specific purpose of the fund and cannot be diverted to any other fund except by dissolving the fund and discontinuing the serial levy.
9. Expenditures can be made directly from the reserve fund only if proper appropriations have been made.
10. If the expenditures are budgeted simply as "reserve for future use" or no expenditure is indicated, a supplemental budget is required to legally spend any amount. This represents a change from the fiscal policy as originally adopted, and creates new appropriations.

Separate Funds For Serial Levies

Under ORS 280.110, a separate fund must be established for each serial levy providing money for a specific purpose. The money received must be retained and expended only for the purpose for which the funds were created. The requirements in this section of the law provide fiscal integrity for the serial levy to accomplish the purpose named in the ballot measure.

As provided in ORS 280.120, if at any time there is no longer a need for expenditures from a special serial levy fund, the governing body may dissolve the fund by transferring the balance and any future proceeds to the general fund. The tax levies for the special fund thereafter shall be discontinued.

During the period of a voter-authorized serial levy, only the amount necessary to meet requirements and balance the fund should be levied each year. The provisions of ORS 294.381 state that although a municipal corporation has the power to levy a tax, the levy should consist only of taxes necessary to balance the budget.

If a municipal corporation has a tax base which exceeds the general operational needs of the budget, the balance of the tax base may be used to substitute for all or a portion of the serial levy. A tax base can be used for any purpose except the repayment of bonded debt.

Use of a tax base in place of a serial levy does not diminish the authority of a serial levy in future years. If in a succeeding year, the full amount of the tax base is required to balance the general operational needs of the budget, then the serial levy may be used once again for the special purpose fund. However, the authorized period for a serial levy is to be consecutive years and if it is not levied for one or more of those years, the authority to levy is not extended.

Bond Sales and Debt Service

Chapter 287 of the Oregon Revised Statutes provides for borrowing and bonds of counties, cities, and districts, generally. The governing body for any municipal corporation must comply with the law when borrowing money or selling bonds and incurring an indebtedness. The importance of disclosure concerning the issuance of municipal bonds has increased in recent years, requiring complete and accurate financial and economic information for all issuers. To aid local governments in dealing with this demand for disclosure, the 1975 Oregon Legislature established the Oregon Municipal Debt Advisory Commission. Staffing for the commission is provided by the Municipal Bond Division of the Oregon State Treasury Department. The commission itself consists of seven members: the State Treasurer; representatives of cities, counties, school districts, and special districts; and two public members.

The Municipal Bond Division, State Treasury Department provides an informational manual for the local bond user entitled, "Capital Budgeting and Bond Issuance." It offers advisory services to issuers who wish to prepare for their own bond sale.

A voter-approved ballot measure authorizes a municipal corporation to sell bonds for a specific purpose and also authorizes a tax levy to pay the bond principal and interest.

ORS 287.006 makes provisions for the "Debt Service Fund" and a tax levy for bonded indebtedness in a sum sufficient to pay the principal and interest. This section of law also requires that any cash on hand or unused working capital within the fund must be invested and the earnings shall be used for the purpose of paying bond principal and interest.

Resources shall not be diverted or used for any other purpose. Generally, transfers from a debt service fund aren't allowed. There are two conditions under which a transfer may be made:

1. Transfer is lawful from this fund in repayment of an interfund loan.

2. If a surplus remains after all interest and principal are paid, the fund may be dissolved and the balance may be transferred to any fund designated by the governing body when the bonds were first sold, or as included in the bond indenture.

Principal and interest payments associated with Bancroft Bonds must be budgeted in a fund entitled, "Bancroft Bond Redemption Fund," per ORS 223.285. This fund shall remain separate and not be comingled with any other debt service fund. ORS 287.012 provides that when bonds are sold, proceeds shall be placed in an improvement fund and used for the purpose for which the bonds were issued. Any proceeds received in excess of the principal from the bond sale shall be placed with the principal in the special fund or in a debt service fund to repay the bond.

Expenditures may be made from bond sale proceeds without making appropriations if voter approval of the bond issue and the bond sale occur within the same fiscal year (ORS 294.326(4)). While it isn't a requirement under Local Budget Law, it would be good fiscal practice for the governing body to adopt a resolution or ordinance authorizing the expenditure.

A capital projects fund of some type must be established to account for the resources and expenditures of the bond sale proceeds. The estimated resources and expenditures must then be shown in the next fiscal budget under the column labeled "adopted budget this year."

If voters approve the bonds during the current fiscal year and the bond sale will occur during the next fiscal year, the bond sale proceeds must be budgeted in the proper manner in the next fiscal budget before the proceeds can be spent. A capital projects fund must be established to receive the anticipated bond sale proceeds and appropriations made.

Payments for bond principal and interest must be appropriated for in a debt service fund. If the first payments come due and were not anticipated, appropriations shall be made by a supplemental budget. For more information, see "Budget Changes After Adoption" and budget Form LB-35 in this manual.